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Brian R Naranjo 03/28/2002 08:01:51 AM From DB/Inbox: Brian R Naranjo

Cable Text:  
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TELEGRAM

March 27, 2002

Chron

To: SECSTATE WASHDC - ROUTINE  
Action: EB  
From: AMEMBASSY CARACAS (CARACAS 807 - ROUTINE)  
TAGS: ECON, FIN, PREL, VE  
Captions: SENSITIVE, SENSITIVE  
Subject: LOW LIQUIDITY AND SKY-HIGH INTEREST RATES INCREASE  
PRESSURE ON VENEZUELA'S FINANCIAL SECTOR  
Ref: CARACAS 000347

RELEASED IN FULL

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Summary  
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1. (SBU) Very high interest rates and the Central Bank of Venezuela's policy of tight liquidity are raising concerns in Venezuela's financial sector over loan portfolio quality. Commercial banks, which have also been hurt by the early February Supreme Court ruling against certain types of indexed mortgage and car loans, have reduced lending. Commercial bank representatives blame the situation on market uncertainty generated by the Government's seeming lack of a coherent economic policy. The current situation does not immediately endanger the financial soundness of the banking system, but is already causing credit problems for the rest of the economy. End Summary.

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Banking performance ratios begin to falter  
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2. (U) Following the government's unexpected February 12th decision to float the currency after months of heavy intervention and expenditure of reserves, the banking sector has experienced a considerable decline in deposits despite extremely high interest rates. In February, the banking sector suffered a 5.53 percent fall in total deposits to Bs. 13.9 trillion (USD \$14.6 billion @ 950 Bs./USD). This follows a reduction of 6.26 percent in the previous twelve months. Over the same period, the sector has suffered a fall off in its total credit portfolio of 4.15 percent. It now stands at Bs. 8.8 trillion (approximately USD \$9.2 billion). And, while the size of the system's loan portfolio decreases, loan quality has deteriorated: in February alone, overdue credits increased by 9.41 percent, restructured credits increased 17.50 percent, and credits in litigation increased 5.26 percent. Overall, the proportion of credits that are either non-performing or require modification of terms comprise 9.0 percent of total loans - not a critical figure, but one whose trend is unfavorable. Loan loss provisions remain adequate and presently cover 125.2 percent of non-performing loans.

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Bankers insist liquidity is far too low  
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3. (SBU) According to banking sources, although capital flight continues to drain the system of deposits, the most worrisome aspect of the current situation is the system's very low excess liquidity. Bankers report that over the past few weeks the Central Bank's open market desk has been compelled repeatedly to redeem government bonds to restore liquidity to several cash-strapped institutions. Experienced financial market observers question how long the low liquidity and high interest rate

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UNITED STATES DEPARTMENT OF STATE  
REVIEW AUTHORITY: JOHN L MILLS  
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environment (lending rates now average 45 percent) can be sustained without material long-term economic damage in the form of bankruptcies, deterioration of loan portfolio quality, and reduced industrial capacity.

4. (SBU) Bank managers and economists blame the Government for a poorly implemented currency float and persistently high interest rates. Transitional volatility was expected immediately after President Chavez's February 12th announcement ending the currency exchange band policy, but industry representatives are perplexed by the apparent lack of an end game. Contradictory statements by senior Government officials regarding the revised 2002 budget and the lack of a credible explanation of the new monetary regime have left markets unsure of the Government's next steps. One result often remarked on by banking sources is that very little of the capital that fled the country before the February 12th float has returned, except for those amounts required for immediate cash needs, such as quarterly tax payments.

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Bank earnings threatened  
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5. (SBU) The current unsettled situation in the financial markets has also increased concerns over the banking sector's earnings for 2002. The government continues to publicly discuss the imposition of interest rates and mandatory quotas for loans to agriculture and micro-enterprises that could threaten earnings. Similarly, the recent Supreme Court decision to void certain types of indexing on already-existing mortgage and car loans is likely to reduce margins still further. (Note: While the Supreme Court decision on the appropriate interest rate for these loans is pending, borrowers have suspended loan payments at the Court's direction.)

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Banking sector still financially sound  
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6. (SBU) Although the financial sector's important performance ratios remain adequate, its ability to perform its traditional role as a financial intermediary is badly impaired. Declining deposits, problems in loan quality, and over-dependence on government debt on the asset side of the banks' balance sheets have left little room for financing the private sector.

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Comment  
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7. (SBU) Thanks to a wave of consolidations and capital infusions during the heady oil price surge of 2000-2001, Venezuela's banking system is fairly well capitalised, weaker institutions have been culled, and most banks can withstand a moderate downturn in earnings. The fact remains, however, that several trends are not favorable to system stability. The government seems unwilling to address the excessively high interest rates, because to do so would release the liquidity dam and risk an accelerated pace of devaluation. In the present interest rate environment, new lending activity has ceased and small and intermediate-sized companies are coming under considerable pressure to meet debt service obligations. A wave of loan defaults, in concert with the already serious drain of deposits, would place significant strain on Venezuela's financial system. According to most banking representatives, there remains sufficient time and capital margin to reverse the sector's deteriorating balance sheet, but they uniformly insist that the Central Bank has to increase liquidity - and transparency - to bring down interest rates. End Comment.

COOK

Additional Addressees:  
None

cc:

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AMEMBASSY BOGOTA

Distribution:

TED5467

ACTION EB-00

INFO	LOG-00	NP-00	ACQ-00	CIAE-00	COME-00	DODR-00	DOTR-00
	WHA-00	SRPP-00	DS-00	FAAE-00	UTED-00	VC-00	TEDE-00
	INR-00	LAB-01	VCE-00	AC-01	MSAE-00	ACE-00	IRM-00
	TEST-00	FMP-00	EPAB-00	DSCC-00	DRL-02	NFAT-00	SAS-00
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UNCLAS CARACAS 000807

SENSITIVE

E.O. 12958: N/A  
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End Cable Text

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